

**AUDIT REPORT
OF THE
NEBRASKA DEPARTMENT OF
ENVIRONMENTAL QUALITY
DRINKING WATER
STATE REVOLVING FUND PROGRAM
JULY 1, 2001 THROUGH JUNE 30, 2002**

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

BACKGROUND

The Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program (Program) was established pursuant to the Federal Safe Drinking Water Act of 1996. Neb. Rev. Stat. Sections 71-5314 to 71-5327 created the Drinking Water State Revolving Fund Act. The Federal Safe Drinking Water Act and State statutes established the Drinking Water State Revolving Fund Program to provide loans, at reduced interest rates, to finance the construction of publicly and privately owned drinking water facilities. Instead of making grants to communities that pay for a portion of the building of drinking water facilities, the Program provides for low interest loans to finance the entire cost of qualified projects. The Program provides a flexible financing source which can be used for a variety of projects. Loans made by the Program must be repaid within 20 years, and all repayments, including interest and principal, must be used for the purposes of the Program. Disadvantaged communities have 30 years to repay all loans.

The Program was capitalized by the United States Environmental Protection Agency (EPA) by a series of grants starting in 1997. States are required to provide an additional 20 percent of the Federal capitalization grant as matching funds in order to receive a Federal grant. As of June 30, 2002, the EPA had awarded almost \$43 million in capitalization grants to the State. The award of this \$43 million required the State to contribute approximately \$9 million in matching funds. The State provided appropriations to contribute \$2.33 million of the funds to meet the State's matching requirement. Additional matching funds were obtained through the issuance of \$5,530,000 in revenue bonds in June of 2000 and \$1,815,000 in revenue bonds in March of 2001.

The Program is administered by the Nebraska Department of Environmental Quality (Department) and the Nebraska Health and Human Services System – Regulation & Licensure. The Department's primary activities with regard to the Program include the making of loans for facilities and the management and coordination of the Program. The Nebraska Environmental Quality Council approves the rules and regulations of the Department and the Program's Intended Use Plan. The Nebraska Health and Human Services System – Regulation & Licensure sets the funding priorities.

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY DRINKING WATER STATE REVOLVING FUND PROGRAM

INDEPENDENT AUDITORS' REPORT

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We have audited the accompanying financial statements of the business-type activities of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program (Program), as of and for the year ended June 30, 2002, as listed in the Table of Contents. These financial statements are the responsibility of the Program's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program, are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities of the State that is attributable to the transactions of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program. They do not purport to, and do not, present fairly the financial position of the State of Nebraska as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program, as of June 30, 2002, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 5, 2003, on our consideration of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

In accordance with the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*, we have also issued our report dated March 5, 2003, on our consideration of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's compliance with certain provisions of laws, regulations, and grants.

March 5, 2003

Pat Reding, CPA
Assistant Deputy Auditor

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM
BALANCE SHEET
June 30, 2002

	Enterprise Fund
ASSETS:	
CURRENT ASSETS:	
Cash and Cash Equivalents:	
Cash in State Treasury (Note 2)	\$ 3,324,157
Deposits Held by Trustee (Note 2)	2,464,112
Investments Held by Trustee (Note 2)	731,232
Loans Receivable - Current (Note 3)	1,338,171
TOTAL CURRENT ASSETS	7,857,672
NONCURRENT ASSETS:	
Loans Receivable (Note 3)	29,205,551
TOTAL NONCURRENT ASSETS	29,205,551
TOTAL ASSETS	\$ 37,063,223
LIABILITIES:	
CURRENT LIABILITIES:	
Accounts Payable	\$ 6,958
Accrued Bond Interest Payable	188,663
Bonds Payable - Current (Note 4)	330,000
TOTAL CURRENT LIABILITIES	525,621
NONCURRENT LIABILITIES:	
Bonds Payable - Long Term (Note 4)	6,855,000
TOTAL NONCURRENT LIABILITIES	6,855,000
TOTAL LIABILITIES	7,380,621
NET ASSETS:	
Restricted for Bond Payments	737,945
Unrestricted	28,944,657
TOTAL NET ASSETS (Note 5)	29,682,602
TOTAL LIABILITIES AND NET ASSETS	\$ 37,063,223

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
 DRINKING WATER STATE REVOLVING FUND PROGRAM
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
 For the Fiscal Year Ended June 30, 2002

	Enterprise Fund
OPERATING REVENUES:	
Loan Fees Administration (Note 6)	\$ 283,193
Interest on Loans	829,811
Interest on Fund Balance Trustee	108,065
Interest on Fund Balance (Note 7)	131,734
TOTAL OPERATING REVENUES	1,352,803
OPERATING EXPENSES:	
15% Source Water Assessment Program (Note 8)	197,098
4% Administration (Note 8)	312,346
2% Technical Assistance to Small Systems (Note 8)	-
10% Public Water Supply System (Note 8)	183,036
30% Loan Forgiveness (Note 8)	760,879
Interest Expense - State Match Bonds	377,325
Cost of Bond Issuance	(1,420)
TOTAL OPERATING EXPENSES	1,829,264
OPERATING LOSS	(476,461)
CAPITAL CONTRIBUTIONS - FEDERAL GRANTS	8,358,257
CHANGE IN NET ASSETS	7,881,796
TOTAL NET ASSETS, BEGINNING OF YEAR	21,800,806
TOTAL NET ASSETS, END OF YEAR	\$ 29,682,602

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM
STATEMENT OF CASH FLOWS
For the Fiscal Year Ended June 30, 2002

	Enterprise Fund
CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts from Customers	\$ 1,753,656
Interest on Investments	239,799
Payments to Borrowers	(8,243,784)
Payments to Employees and Vendors	(687,441)
Loan Forgiveness	(760,879)
Bond Principal Payments	(160,000)
Bond Interest Payments	(360,529)
NET CASH PROVIDED BY OPERATING ACTIVITIES	(8,219,178)
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES:	
Funds Received from Environmental Protection Agency	8,358,257
NET CASH FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES	8,358,257
NET INCREASE IN CASH AND CASH EQUIVALENTS	139,079
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	6,380,422
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 6,519,501
 RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Operating Loss	\$ (476,461)
ADJUSTMENTS TO RECONCILE OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
(Increase) in Loans Receivable	(7,603,132)
(Decrease) in Bonds Payable	(160,000)
Increase in Accrued Bond Interest Payable	16,796
Increase in Accounts Payable	5,039
(Decrease) in Bond Issuance Payable	(1,420)
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ (8,219,178)

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2002

1. Summary of Significant Accounting Policies

- A. **Basis of Presentation.** The accompanying financial statements of the Nebraska Department of Environmental Quality (Department) - Drinking Water State Revolving Fund Program (Program) have been prepared in conformance with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial statements have been prepared primarily from accounts maintained by the State Accounting Administrator of the Department of Administrative Services and the Trustee (Wells Fargo Bank, Iowa) for the State match bond accounts.

- B. **Reporting Entity.** The Drinking Water State Revolving Fund Program is a program within the Department and is established under and governed by the Safe Drinking Water Act of the Federal Government and the Drinking Water State Revolving Fund Act of the State of Nebraska. The Department is a State agency established under and governed by the laws of the State of Nebraska. As such, the Department is exempt from State and federal income taxes. The Program's management has also considered all potential component units of the Program for which it is financially accountable, and other organizations which are fiscally dependent on the Program's management, or the significance of their relationship with the Program's management are such that exclusion would be misleading or incomplete. GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Department to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Department.

As required by generally accepted accounting principles, these financial statements present the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program. No component units were identified. The Program is part of the primary government for the State of Nebraska's reporting entity.

- C. **Fund Structure.** The Program's accounts are maintained in accordance with the principles of fund accounting to ensure compliance with limitations and restrictions placed on the use of resources available to it. Under fund accounting,

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. Summary of Significant Accounting Policies (Continued)

individual funds are established for the purpose of carrying on activities or attaining objectives in accordance with specific regulations, restrictions, or limitations. Each individual fund is a self-balancing set of accounts recording cash and other financial resources, together with liabilities and residual equities or balances, and changes therein. The Program is made up of four funds on the State of Nebraska Accounting System. It includes the following funds as identified in the State Drinking Water State Revolving Fund Act:

- Drinking Water Facilities Fund – General Fund 1000, Federal Fund 4841, and Trust Fund 6848
- Land Acquisition and Source Water Loan Fund – Federal Fund 4841
- Drinking Water Administration Fund – Cash Fund 2863.

These funds are used to account for revenues and expenses for loans and administrative expenses of the Program.

The activity of these four State of Nebraska funds have been combined and reported as an enterprise fund, which under governmental GAAP is a proprietary fund type. This fund type reflects transactions used to account for those operations that are financed and operated in a manner similar to a private business. The accounting for the Fund's transactions in this manner is a requirement of the Environmental Protection Agency (EPA) as they and the Department have decided that the determination of revenues earned, expenses incurred, and/or net income is necessary to demonstrate the success of the Program and to assure the EPA that the Program will be available in perpetuity as intended.

- D. Basis of Accounting.** The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. An enterprise fund is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of the fund are included on the balance sheet. Enterprise fund operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

Enterprise funds utilize the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

In reporting the financial activity of its enterprise fund, the Program's management applied all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. **Summary of Significant Accounting Policies (Concluded)**

pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinion, and Accounting Research Bulletins of the Committee on Accounting Procedures.

E. Cash and Cash Equivalents. Cash in State Treasury, Deposits Held by Trustee, and Investments held by Trustee are considered cash equivalents due to their liquid nature.

F. Loans Receivables. The State operates the Program as a direct loan program, whereby loans are made to communities. The entire Drinking Water Program is funded, on the average, 83.33% from federal capitalization grants and 16.67% from State matching funds. Loan funds are disbursed to the local agencies as they expend funds for the purposes of the loan. Interest is calculated from the date that funds are advanced, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and accrued interest during the project period. The interest rates on loans range from 3% to 4% and the terms are between 5 to 20 years. Disadvantaged communities may have up to 30 years to repay. The current loans receivable amount was determined using the amount of principal payment due to the Program at June 30, 2002, which was collectible in fiscal year 2003.

No provisions were made for uncollectible accounts as all loans were current, and management believed all loans would be repaid according to the loan terms. There was a provision for the Program to intercept State aid to a community in default of its loan.

G. Accounts Payable. Due to limitations of the State of Nebraska Accounting System a cutoff must be made on July 31st of each year when determining the amount of accounts payable that exists for the current year. Any information that would change this figure will be disregarded and shown as an expense of the year the payment is made and not when the liability is incurred.

H. Restricted Net Assets. When both restricted and unrestricted resources are available for use, it is the Department's policy to use restricted resources first, then unrestricted resources, as they are needed. Net assets are reported as restricted when they are held in a separate account that can be used to pay debt principal and interest only and cannot be used to pay other current liabilities.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. **Cash and Cash Equivalents**

Cash in State Treasury. Cash in State Treasury as reported on the balance sheet is under the control of the State Treasurer or other administrative bodies as determined by law. All cash deposited with the State Treasurer is maintained in a short-term investment pool. The State Investment Officer invests the deposited cash in short-term securities and other investments. All interest revenue is allocated to the general fund except allocations required by law to be made to other funds. All funds of the Drinking Water State Revolving Fund Program were designated for investment during fiscal year 2002. Amounts are allocated on a monthly basis based on average balances of all invested funds.

Deposits Held by Trustee and Investments Held by Trustee. The Nebraska Investment Finance Authority (NIFA) (the "Issuer") issues revenue bonds payable by the Department from certain portions of the fund (see Bonds Payable) to provide additional funds to meet the 20% match requirements of the Capitalization Grants. Wells Fargo Bank Iowa, National Association, (Trustee), as trustee, holds these accounts. The Trustee, in accordance with the Bond Indenture, establishes the appropriate accounts and invests the monies. At June 30, 2002, the cash held by the trustee of \$3,195,344, stated at Fair Market Value, was invested in the following investments:

	Fair Market Value
Cash	\$ 27,304
Money Market Account	2,436,808
Guaranteed Investment Contracts (GICs)	731,232
Total	<u>\$ 3,195,344</u>

In accordance with the GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, deposits and investments are to be categorized as to custodial credit risk. The Cash and Money Market Accounts with a carrying amount and bank amount of \$2,464,112 were uninsured and uncollateralized during and at the end of fiscal year 2002.

GICs are not required to be categorized as to custodial credit risk under GASB Statement No. 3.

3. **Loans Receivable**

As of June 30, 2002, the Program had made loans to 48 communities that totaled \$30,543,722. The outstanding balances of the largest eight loans, which represent approximately 62 percent of the total loans, were as follows:

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

3. Loans Receivable (Concluded)

City	Outstanding Balance
Arlington	\$ 1,447,944
Blair	6,796,950
Ceresco	1,050,807
Falls City	1,792,745
Kearney	1,822,652
Norfolk	1,647,999
North Platte	3,077,844
Plattsmouth	1,455,112
Total	\$ 19,092,053

4. Bonds Payable

The State has entered into a special financing arrangement with NIFA, an independent instrumentality of the State exercising essential public functions, to provide matching funds for the State's Drinking Water Program. NIFA issues the bonds, and proceeds are held by the Trustee until needed by the Program for loan purposes. The Series 2000A and 2001A Bonds are limited obligations of NIFA, payable only from and secured only by the Trust Estate. The Series 2000A and 2001A Bonds are revenue bonds. The Series 2000A and 2001A bonds shall not constitute a debt, liability, general obligation of the State, or a pledge of the faith and Credit of the State, but are payable solely out of the revenue or money NIFA pledged to the Trust Estate. Neither the faith and credit nor the taxing power of the State is pledged to the principal of, premium, if any, or the interest on the Series 2000A or 2001A Bonds. The current bonds payable amount was determined using the amount of bond principal to be retired in fiscal year 2003. Bonds payable for the fiscal year ended June 30, 2002, is as follows:

	Beginning Balance	Additions	Retirements	Ending Balance	Current Portion
Bonds Payable	\$7,345,000	\$ -	\$ 160,000	\$7,185,000	\$ 330,000

Bonds payable at June 30, 2002, consist of the following:

Series	Original Issue	Retirements	2002 Balance	Interest Rates	Final Maturity Date
1999	\$2,000,000	\$2,000,000	\$ -	-	-
2000A	5,530,000	160,000	5,370,000	4.8-5.7%	July 1, 2015
2001A	1,815,000	-	1,815,000	3.9-5.15%	Jan 1, 2016

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

4. Bonds Payable (Concluded)

The 2000A Series Bonds were issued June 29, 2000 and the 2001A Series Bonds were issued March 29, 2001. Bonds mature at various intervals through July 2016. The debt service requirements on bonds maturing in subsequent years are as follows:

Year Ending June 30	Principal	Interest	Total
2003	\$ 330,000	\$ 371,200	\$ 701,200
2004	345,000	355,321	700,321
2005	365,000	338,443	703,443
2006	375,000	320,500	695,500
2007	395,000	301,678	696,678
2008-2012	2,315,000	1,177,844	3,492,844
2013-2016	3,060,000	427,310	3,487,310
Total	<u>\$ 7,185,000</u>	<u>\$ 3,292,296</u>	<u>\$ 10,477,296</u>

Series 2002A Bonds for \$2,000,000 were issued in December 2002. These bonds are not included in the debt service requirement schedule.

5. Net Assets

Included in the Net Assets is the total amount of capitalization grants drawn from the EPA by the Department. The following summarizes the EPA capitalization grants awarded, drawn, and the remaining balance as of June 30, 2002.

Year	Grant Amount	Amount Drawn	Balance
1997	\$ 12,824,000	\$ 11,437,971	\$ 1,386,029
1998	7,121,300	6,005,994	1,115,306
1999	7,463,800	6,540,193	923,607
2000	7,757,000	6,521,079	1,235,921
2001	7,789,126	1,960,098	5,829,028
Totals	<u>\$ 42,955,226</u>	<u>\$ 32,465,335</u>	<u>\$ 10,489,891</u>

The following is a summary of changes in the total contributed capital.

Contributed Capital July 1, 2001	\$ 26,435,914
Contributed During the Year	
Funds Received From EPA	8,358,257
Contributed Capital June 30, 2002	<u>\$ 34,794,171</u>

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

5. Net Assets (Concluded)

Also included in the Contributed Capital is a total of all general funds received by the Program from the Legislature of the State of Nebraska. These assets were to be used as match for the Program for the initial capitalization grant received by the State. The State contributed \$1,162,318 and \$1,166,518 in fiscal years ended June 30, 1998 and 1999, respectively.

6. Loan Fees Administration

The reported amount comes from a fee charged to loan recipients each year based on the amount of the loan outstanding. The fee is 1% per annum and is collected semi-annually. Of the total collected, \$0 was used as match for the capitalization grant.

7. Interest on Fund Balance Held by State Treasurer

The reported amount represents the earnings the Program has received from idle funds invested by the Treasurer of the State of Nebraska. Interest is credited on approximately the twenty-fifth day of each subsequent month.

8. Operating Revenues and Expenses

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Program's principal ongoing operations. The principal operating revenue of the Program is the Loan Fees Administration. Interest revenues are also operating revenues since making loans is the primary purpose of the Program. The principal operating expenses of the Program are administration expenses and loan forgiveness. Interest expenses are also operating expenses since making loans is the primary purpose of the Program.

9. Operating Expenses

The Operating Expenses of the Drinking Water State Revolving Fund Program are classified, for financial reporting purposes, into seven categories. There are four set-aside activities established under Section 1452 of the Safe Drinking Water Act. The four set-aside activities are:

- 15% Source Water Assessment Program
- 4% Administration
- 2% Technical Assistance to Small Systems
- 10% Public Water Supply System

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

9. Operating Expenses (Continued)

All are required to be federally funded. State match dollars can only be used for the purpose of providing loans to owners of Public Water Supply Systems. The other categories of expenses are; 30% Loan Forgiveness, Interest Expense-State Match Bonds, and Cost of Bond Issuance.

Following is an explanation of each category:

15% Source Water Assessment Program

Identified in federal regulations as local assistance and other state programs, the State may use up to 15% of the capitalization grant amount for specified uses as follows:

- Assistance to a public water system to acquire land or a conservation easement for source water protection purposes;
- Assistance to a community water system to implement voluntary, incentive-based source water quality protection measures;
- Provide funding to delineate and assess source water protection areas;
- To support the establishment and implementation of wellhead protection programs;
- To provide funding to a Public Water System to implement a technical and/or financial assistance under the capacity development strategy.

4% Administration

A state may use up to 4 percent of the funds allotted to it for the reasonable costs of administering the program, and providing technical assistance. These costs may include such activities as issuing debt; start up costs; audit costs; financial management; legal consulting fees; development of IUP (Intended Use Plan) and priority ranking system; development of affordability criteria; and costs of support services provided by other state agencies. If the state does not obligate the entire four-percent for administrative costs in one year, it can bank the excess balance and use it for administrative costs in later years.

2% Technical Assistance to Small Systems

A state may use up to 2 percent of its allotment to provide technical assistance to public water systems serving 10,000 people or less. If the state does not use the entire 2 percent for these activities against a given allotment, it can bank the excess balance and use it for the same activities in later years. A state may use these funds to support a technical assistance team or to contract with outside organizations to provide technical assistance.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

9. Operating Expenses (Concluded)

10% Public Water Supply System

A state may use up to 10 percent of its allotment to:

- Administer the state Public Water Supply System program;
- Administer or provide technical assistance through source water protection programs, which includes the Class V portion of the Underground Injection Control Program;
- Develop and implement a capacity development strategy; and
- Develop and implement an operator certification program.

30% Loan Forgiveness

The amount of expenses reported as Loan Forgiveness is the amount the State forgave loans to Communities meeting the definition “disadvantaged” or, which the State expects the Community to become disadvantaged as a result of the project. The amount of these subsidies during a particular fiscal year’s capitalization grant cannot exceed 30 percent of the amount of the capitalization grant for that year.

The Nebraska Department of Health and Human Services is provided funding under the following set-asides: Administrative, Public Water Supply System, and Small Systems Technical Assistance. A Memorandum of Understanding was entered into between the Department and the Department of Health and Human Services to provide support of the Program.

Interest Expense-State Match Bonds

The amount is interest paid to bond holders at the time bond principal was retired during the fiscal year.

Cost of Bond Issuance

The amount is payments to NIFA and the Trustee to issue the 2001A Bonds. The amount is negative, as a payable for these expenses was recorded for the fiscal year ending June 30, 2001, that was never paid.

10. State Employees’ Retirement Plan (Plan)

The Plan is a single-employer defined contribution plan administered by the Public Employees Retirement Board in accordance with the provisions of the State Employees Retirement Act and may be amended through Legislative action. In the defined contribution plan, retirement benefits depend on total contributions, investment earnings,

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

10. **State Employees' Retirement Plan (Plan) (Concluded)**

and the investment options selected. Prior to April 18, 2002 membership in the Plan was required of all permanent full-time employees on reaching the age of thirty and completion of twenty-four months of continuous service and voluntary participation was permitted for all permanent full-time or part-time employees upon reaching age twenty and twelve months of service within a five-year period. Any individual appointed by the Governor may elect not to become a member of the Plan. Legislative Bill 687 (2002), effective April 18, 2002, stated all permanent full-time employees shall begin participation in the Plan upon completion of twelve continuous months of service.

Employees contribute 4.33% of their monthly compensation until such time as they have paid during any calendar year a total of eight hundred sixty four dollars, after which time they shall pay a sum equal to 4.8% of their monthly compensation for the remainder of such calendar year. The Department matches the employee's contribution at a rate of 156% of the employee's contribution.

The employee's account is fully vested. The employer's account is vested 100% after five years participation in the plan (prior to April 18, 2002) or at retirement. Legislative Bill 687 (2002), effective April 18, 2002, changed the vesting requirement to a total of three years of participation in the system, which includes the twelve-month eligibility period or credit for participation in another governmental plan prior to actual contribution to the Plan.

For the fiscal year ended June 30, 2002, the Drinking Water State Revolving Fund Program's employees contributed \$8,588 and the Department contributed \$13,398 for these employees.

11. **Contingencies and Commitments**

Risk Management. The Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; natural disasters; and health care insurance. The Department, as part of the primary government for the State, participates in the State's risk management program. The Nebraska Department of Administrative Services (DAS) Division of Risk Management is responsible for maintaining the insurance and self-insurance programs for the State. The State has chosen not to purchase insurance except for:

1. Motor vehicle liability which is insured for the first \$5 million of exposure per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles.
2. Health care insurance for employees selecting certain coverage options. All health care insurance was purchased.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

11. Contingencies and Commitments (Concluded)

3. Employee dishonesty which is bonded for the first \$1 million annually with a \$10,000 retention per incident.
4. Real and personal property on a blanket basis for net loss in excess of \$200,000 per loss occurrence, with a limit of \$250,000,000 per loss occurrence. Newly acquired properties are only covered up to \$1,000,000 for 60 days or until the value of the property is reported to the insurance company. The perils of flood and earthquake are covered up to \$10,000,000.

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Risk Management Internal Service Fund through a combination of employee and State contributions. Workers compensation is also funded in the Risk Management Internal Service Fund through assessments on each agency based on total agency payroll and past experience. Tort claims, theft of, damage to, and destruction of assets; errors and omissions; and natural disasters would be funded through the State General Fund or by individual agency assessments as directed by the Legislature, unless covered by purchased insurance. No amounts for estimated claims have been reported in the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's financial statements.

12. GASB 34

In June 1999, GASB issued Statement No. 34, Basic Financial Statements – and Management Discussion and Analysis – for State and Local Governments. The State of Nebraska implemented the Statement for the fiscal year ended June 30, 2002.

The Department implemented GASB 34 by presenting its financial statements in a format as required by GASB 34. However, as explained in Note 1.D. the Program's financial statements are presented on the accrual basis of accounting. Previous period financial statements of the Program were also prepared on the accrual basis of accounting; therefore, these financial statements, even though in different format, are comparable to previous period financial statements of the Program.

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY DRINKING WATER STATE REVOLVING FUND PROGRAM REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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We have audited the financial statements of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program as of and for the year ended June 30, 2002, and have issued our report thereon dated March 5, 2003. The report was modified to emphasize the financial statements present only the funds of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial

statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program in a separate letter dated March 5, 2003.

This report is intended solely for the information and use of the Program, the appropriate Federal and regulatory agencies, and citizens of the State of Nebraska, and is not intended to be and should not be used by anyone other than these specified parties.

March 5, 2003

Pat Reding, CPA
Assistant Deputy Auditor

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO THE NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY DRINKING WATER STATE REVOLVING FUND PROGRAM IN ACCORDANCE WITH U.S. ENVIRONMENTAL PROTECTION AGENCY AUDIT GUIDE FOR CLEAN WATER AND DRINKING WATER STATE REVOLVING FUND PROGRAMS

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We have audited the compliance of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program with the types of compliance requirements described in the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs* that were applicable for the year ended June 30, 2002. We audited the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program’s compliance with requirements governing: Allowability for Specific Activities, Allowable Costs/Cost Principles, Cash Management, State Matching, Period of Availability of Funds and Binding Commitments, Program Income, Reporting, Subrecipient Monitoring, and Special Tests and Provisions. Compliance with these requirements is the responsibility of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program’s management. Our responsibility is to express an opinion on the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program’s compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on the Program occurred. An audit includes examining, on a test basis, evidence about the Nebraska Department of

Environmental Quality – Drinking Water State Revolving Fund Program’s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program’s compliance with those requirements.

As identified below and in a separate letter to the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program’s management dated March 5, 2003; the Department did not comply with the following requirements.

- The Department has not filed their annual financial status report with the United States Environmental Protection Agency (EPA) for the federal fiscal year ending September 30, 2002. This report was due December 31, 2002.
- The Department did not file their annual report with the EPA for the State fiscal year ending June 30, 2002 in a timely manner. The report was due September 30, 2002, but was not filed until January 2003.
- The Department has not filed their quarterly federal cash report since January 2002. The reports were due within 15 days following the end of each quarter.
- The Department advanced \$183,036 to the Nebraska Health and Human Services System for payroll costs. This advance did not comply with federal cash management procedures.

In our opinion, except for the reporting noncompliance issues described in the preceding paragraph, the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program complied, in all material respects, with the requirements referred to above that are applicable to the Program for the fiscal year ended June 30, 2002.

This report is intended solely for the information and use of the Program, the federal awarding agencies, and citizens of the State of Nebraska, and is not intended to be and should not be used by anyone other than these specified parties.

March 5, 2003

Pat Reding, CPA
Assistant Deputy Auditor